

Business
Council of
Australia



Business Council of Australia

Submission to the

**Centre for International Economics Review of the Carbon
Pollution Reduction Scheme White Paper**

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EXECUTIVE SUMMARY

The BCA's vision is for Australia to be the best place in the world in which to live, learn, work and do business and for it to become and remain a top-five economy among OECD countries by 2012. The overriding objective is to enhance prosperity in Australia.

The BCA makes this submission giving consideration to Australia's long-term economic prosperity, as it is the strength of Australia's economy and viability of Australia's businesses which will ensure we are able to respond to economic, social and environmental challenges including climate change.

The drafting of legislation and the development of an implementation framework for the government's emissions trading scheme, that is, the Carbon Pollution Reduction Scheme, is occurring at a time of a sudden and severe downturn in the global economy, which in turn has brought significant uncertainty about Australia's short-term economic outlook, with likely flow-on concerns, for example due to the terms of trade impact over the medium term.

In light of this, the finalisation of the scheme details and the implementation, especially in the early years, will require a tailored approach that is aligned to global and national economic conditions and designed to ensure Australia's industry and employment opportunities are not adversely impacted.

This does not mean Australia should walk away from the ongoing international negotiations, nor does it mean work on the details of the CPRS should be stalled. What it does mean is making sure the introduction of the CPRS does not lead to further economic, environmental and social uncertainty.

INTRODUCTION

The Business Council of Australia (BCA) represents the chief executives of over 100 of Australia's leading companies. The BCA develops and advocates, on behalf of its members, public policy reform that positions Australia as a strong and vibrant economy and society. The businesses that the BCA members represent are among Australia's largest employers and represent a substantial share of Australia's domestic and export activity. Therefore they have a significant interest in the scope and direction of economic reform.

The BCA's vision is for Australia to be the best place in the world in which to live, learn, work and do business and for it to become and remain a top-five economy among OECD countries by 2012. The overriding objective is to enhance prosperity in Australia.

Such an objective is not at odds with effective environmental management, but does require reforms aimed at 'internalising' environmental costs and risks, most notably with regard to greenhouse gas emissions and the risks associated with climate change.

However, the introduction of such reforms in the absence of a global response and in the current economic climate must be in a manner that does not disadvantage Australia's competitiveness or put employment at risk, rather in a manner that ensures a smooth long-term transition to a low emissions economy.

This submission highlights the policy framework which should underpin Australia's response to climate change and raises a number of issues which need to be considered as the CPRS design and implementation details are being finalised, given the current economic situation.

CLIMATE CHANGE POLICY DESIGN CONSIDERATIONS

In considering the policy frameworks that should underpin the response to the potential risks associated with climate change, the BCA has been cognisant that a long-term prosperous economy will be essential to dealing with the possible social and structural consequences of a transition to a low-emissions economy. It also recognises the global nature of the emissions reduction challenge and the need for concerted international action by all major emitting countries.

Decisions related to climate change policy and action should be developed taking account of the following six critical considerations:

1. An effective, sustainable response to climate change is ultimately about moving from our current high-emission global economy, of which Australia is part, to a low-emission global economy. This is a complex transition that will impact all nations and the communities and business of those nations.
 2. The challenge of controlling emissions, and hence climate change, will be won or lost at a global level. Developing countries will likely contribute 70 per cent of the growth in future world emissions, and will soon be the source of the majority of world emissions.
 3. The most effective system to reduce emissions is one primarily based on a market solution. Market structures provide the basis for the identification of least-cost solutions and build in the incentives to innovate.
 4. Given the scope and scale of the transition implicit in effectively reducing emissions, a multifaceted approach is essential. While a market-based solution is the primary vehicle, other supporting policies and initiatives will be required to ensure the research and development necessary to identify technology solutions, including developing low-emissions technologies, improving energy efficiency and building Australia's adaptation capabilities.
 5. The necessity of a globally based solution does not mean Australia cannot make a significant contribution to such a solution, or demonstrate leadership by formulating responses that can be used as a template or guide for other countries to adopt.
 6. Australia can and should implement strategies nationally that:
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- reduce emissions relative to a business-as-usual outlook;
- ensure the abatement is that which is lowest cost;
- include arrangements to address the impacts on trade-exposed, emissions-intensive industries in the absence of a global carbon price;
- facilitate the long-term and smooth transition of the electricity sector to low-emissions technologies; and
- provide investment certainty to enterprises and investors.

The BCA has released a number of publications on climate change and emissions trading that address these matters in further detail.

Modelling Success: Designing an ETS that Works, released in August 2008, provides a detailed analysis of two critical elements of any emissions trading scheme: how to address the impacts on emissions-intensive, trade-exposed industries in the absence of a global carbon price, and issues to be addressed to facilitate the long-term and smooth transition of the electricity sector to one based on low-emissions technologies.

Modelling Success also highlighted a number of critical policy deficiencies in aspects of the government's green paper proposals for the CPRS.

A copy of this publication is attached.

REVIEWING THE CARBON POLLUTION REDUCTION SCHEME

In December 2008, the government provided the final model of its CPRS and emissions targets for 2020.

With the implementation of the CPRS, businesses and households will face changes in their cost structures unless they are able to offset the direct and indirect impacts of the energy price increases.

For some businesses these costs will be substantial and addressing them will require investment to offset the impacts and reduce emissions.

Emissions-intensive and trade-exposed industries will be unable to pass the costs through and will face significant impacts on their competitiveness unless arrangements are included in the CPRS to offset the costs impact in the absence of a global price.

The government's white paper includes mechanisms to offset the impact of the CPRS on EITE industries. This approach is a substantial improvement on the options explored in the green paper released earlier in 2008.

However, the mechanisms in the CPRS which aim to reduce the impact of the CPRS on EITE industries until global competitors have a carbon price will not totally offset the impacts of the CPRS.

Overall, for EITE industries the combination of having to purchase 40 per cent and 10 per cent of their permits, the annual reduction in permits allocated and the increased price of carbon will still result in additional costs that they are unlikely to be able to pass on to their customers in the absence of key competitors facing a comparable carbon price. These additional costs on EITE industries will adversely impact their business operations, in some cases reducing competitiveness and returns.

Low-emissions technology development and deployment in the electricity sector will be essential to ensuring Australia can contribute to global emissions reduction.

Although the white paper has provided mechanisms to support the transition of the electricity sector to low-emissions technology, more work is required to ascertain whether the policy approaches and levels of transition assistance described will achieve this outcome without risks to reliability and supply of electricity and ensure an environment that facilitates new investment in electricity infrastructure.

Assistance to the electricity sector is required to ensure there is not an immediate reduction in generators' credit ratings and/or breaches of financial ratios (following on from the immediate loss in asset value) as this impact on the operations of the electricity market. It is worth noting that the number of Australian Emission Units (AEUs) with no charge applied to them for the entire electricity sector represents only 13 per cent of its total greenhouse gas emissions, and less than a third of the asset value loss as forecast by two of the three modelling consultants appointed by Treasury.

The BCA is informed that there is approximately \$5 billion of debt due to be refinanced between 2009 and 2012 by base-load coal-fired power plant in the NEM. The proposed change in law by the CPRS is likely to exacerbate the difficulty with refinancing this necessary infrastructure. The timing of the debt repayment, and cost of CPRS, may also cause difficulties for directors of a number of electricity businesses as to whether or not they are a 'going concern' (which in turn will affect their ability to trade). Connected with this, it is understood a number of electricity companies have recommended the government underwrite the debt for all coal-fired power plant.

The removal of electricity retail price caps remains an outstanding issue which becomes more important as the full cost of CPRS, renewables, energy efficiency and other initiatives unfold.

As well as the matters raised above there are a number of areas where further work on the details will be critical. These include:

- Ensuring consistency in the principles and guidelines which underpin various aspects of the scheme design. For example, it would appear coal meets the EITE 1000 threshold but is excluded and treated differently
- Developing a clear framework for the regular reviews including terms of reference, conduct of reviews and matters for consideration.
- The definitions and operation of the threshold tests for eligibility as an EITE industry.
- Criteria for the conclusion of the administrative allocation of permits to EITE industries.
- Operation of the price cap.
- Application of the electricity factor.
- Criteria for and operation of appeal and review mechanisms.

The white paper does not address two other essential issues.

The first is the plethora of federally and state-based programs related to emissions reduction and the take-up of alternative forms of energy supply that have the potential to

reduce the effectiveness of the emissions trading scheme, increase regulatory and administrative burden of business and prevent the attainment of least-cost emissions reduction.

The second is the requirement for clear policies that facilitate ongoing investment and support for research and development efforts related to low-emissions technologies.

It will be important to address these matters in parallel to the introduction of the CPRS.

What is evident now, given the scale and projected duration of the global economic downturn and the impact in Australia, is the need to not only get these details of the CPRS right but to calibrate the introduction and operation of the CPRS to ensure it does not exacerbate the impact of the economic downturn or unduly slow the recovery in economic growth.

THE ECONOMIC OUTLOOK

The economic outlook has worsened since the release of the government's white paper both in terms of the depth of the economic decline and its likely duration.

The global economy has deteriorated rapidly and sharply, even compared with expectations in late 2008.

The most recent IMF forecasts are for a contraction of growth in the major advanced economies of $\frac{1}{4}$ per cent in 2009. If this eventuates, it will be the first contraction in economic activity in those economies since World War II.¹ This compares with a forecast for growth of $1\frac{1}{4}$ per cent less than 12 months ago.²

Global growth is now projected by the IMF to be 2.2 per cent in 2009, compared with $3\frac{3}{4}$ per cent in 2008 and 5 per cent in 2007. This is a very significant slowdown. In April last

¹ International Monetary Fund (IMF), 'IMF Urges Stimulus as Global Growth Marked Down', *IMF Survey Magazine*, 6 November 2008.

² IMF, *World Economic Outlook*, April 2008.

year, the IMF was predicting that the global economy would grow in 2009 at a still-healthy 3¾ per cent.

The United States, Japan, the United Kingdom and European Union are in recession. The economies of China and India are also expected to slow. Projections at this stage are for relatively modest reductions in growth, although more recent information provided by the IMF, OECD and the World Economic Forum suggests that China, in particular, may be slowing by more and much faster than expected.³ This suggests that further downward revisions in economic forecasts around the world are likely.

Australia is in a stronger position relative to other countries. It entered this difficult period on the back of 17 years of sustained economic growth, record lows in unemployment, fiscal surpluses and low levels of public debt. This does not shield us from the global situation.

Recent data suggests Australia faces weak consumer spending and business investment growth and a substantial drop in demand for its exports. Where just a year ago excessive demand was exposing Australia's supply constraints, we now find economic demand needs support.

³ Between October and November 2008, the IMF revised downwards its 2009 forecasts for growth in China from 9.3 per cent to 8.5 per cent and for India from 6.9 per cent to 6.3 per cent. The OECD has warned of a 'strong slowdown' in China (OECD, 'Composite Leading Indicators Signal Deep Slowdown in OECD Area and Major Non-OECD Member Economies', news release, 12 January 2009, Paris) The World Economic Forum says that decline in demand for China's exports is 'increasing considerably' the risk of a 'hard landing' (World Economic Forum, *Global Risks 2009* report, January 2009).

IMPLEMENTING THE CARBON POLLUTION REDUCTION SCHEME

It is essential to address the outstanding design detail of the CPRS as discussed above.

In doing so, efforts must ensure the CPRS results in abatement that is lowest cost and that emissions-intensive trade exposed industries are addressed in a manner that does not see them disadvantaged in the absence of a global carbon price.

Given the severe and sudden deterioration in economic and financial circumstances the CPRS should be implemented in a manner that does not expose business operations to excessive imposts. Rising capital costs and pressure on cash flows are now significant issues across business and will impact the capacity to manage the impacts of the CPRS. In this environment, additional uncertainty and risk will adversely affect investment decisions.

It will be particularly important to facilitate the smooth, long-term transition of the electricity sector to low emissions technologies and to provide the basis for ongoing investment.